the various "adders" to the DCF cost of equity (which increase the return on equity by about 100 basis points) are no longer needed.

The cost of capital for the local exchange telephone companies follows trends in national and international financial markets. These changes are largely beyond the control of telephone company management. For that reason, it is appropriate for the FCC to revisit the cost of capital from time to time, i.e., every three to five years, and adjust interstate service rates and earnings sharing thresholds for the change in market conditions.

Q. HOW HAVE YOU ORGANIZED THE REMAINDER OF YOUR STATEMENT?

A. The next section briefly describes trends in capital costs and directly compares interest rates today versus those at the time of the FCC's previous rate of return proceeding in 1990. Section IV presents my updated DCF analysis. That section also examines risk indicators today versus those in 1990 for the Bell companies. Section V presents preliminary information on capital structure and cost of debt and combines that information to produce my recommended overall rate of return. The last section briefly explores the need for an automatic adjustment factor for interest rate changes. Data tables supporting my Statement are attached.

III. CAPITAL COST TRENDS

Q. PLEASE DESCRIBE THE TRENDS IN CAPITAL COSTS SINCE CC DOCKET NO. 89-624 IN 1990.

A. I have prepared Table 1 which provides detailed information on several capital cost indicators over the time period January 1990 through March 1994. (Full month averages for April are not yet available.) As this table indicates, there has been a clear and pronounced downward trend in capital costs since 1990, with interest rates reaching their low point in the fall of 1993. Interest rates have moved back up since the October 1993 low point, but as of March 1994 remained more than two full percentage points below rates in 1990 -- the point in time when the 11.25 percent overall return was authorized.

Q. WHAT EXPLAINS THE IMPROVEMENT IN CAPITAL COSTS SINCE 1990?

A. Capital costs remained stubbornly high in 1990 in response to several key factors in financial markets including problems with the banking system, heightened concerns over the federal deficit, increases in interest rates overseas and inflation. Inflation accelerated to nearly 6 percent in 1990, and interest rates increased and stock prices fell in response. Problems in financial markets were exacerbated by the onset of the Middle East crisis in August 1990, with the resultant rising oil prices. The subsequent resolution of the Gulf War in early 1991 helped ease investor concerns over inflation and interest rates.

A clear trend of improving capital costs became evident in late 1991. During late 1991 and 1992, the Federal Reserve lowered its discount rate and the federal funds rate on several occasions, responding to a weak economy and the Fed's desire to pursue a policy of monetary easing. The weakness in the U.S. economy

and the slow rate of recovery has also helped to moderate inflation, which has averaged about 3 percent during the past two years. Capital cost improvements in 1993 also have been helped by actions taken to deal with the federal deficit.

The low point was reached in late 1993 with double A utility bond yields falling below 7.0 percent and ten-year Treasury bond yields declining below 6.0 percent. Interest rates gradually drifted upward through January 1994, and during the past three months markets have been very unstable.

Q. WHAT ACCOUNTS FOR THE UPWARD TREND IN RECENT MONTHS AND THE CURRENT INSTABILITY?

A. The increase in capital costs over the past six months is not fully understood, and according to some commentators, is not warranted by underlying fundamental conditions. In general, some of the upward pressure appears to come from a strengthening U.S. economy. GDP in the fourth quarter 1993 surprised markets by growing at an annual rate in excess of 7 percent. In response to this strengthening, the Federal Reserve Board has taken steps to increase short-term interest rates. Other possible causes of the bond market instability may include recent difficulties in U.S./Japanese trade relation, the behavior of highly leveraged hedge investment funds and instability in foreign bond markets.

Q. WHAT IS THE CURRENT OUTLOOK?

A. While no one can be certain what will happen in capital markets, in general, analysts remain optimistic. The inflation fundamentals are viewed as positive, and the 7 percent fourth quarter 1993 GDP growth is viewed as an aberration. Forecasters are predicting a slowing of economic growth to a more moderate 3.0 to 3.7 percent range over the next two years.

Q. WHAT IS THE INTEREST RATE OUTLOOK AMONG ECONOMIC FORECASTERS?

A. In the table below, I present the near-term and long-term forecasts published by Blue Chip Economic Indicators. The Blue Chip "consensus" forecasts are essentially averages of the forecasts submitted to Blue Chip by approximately 40 to 50 major organizations. Blue Chip publishes its short-term forecasts monthly, while its long-term forecasts are published in March and October of each year.

The latest Blue Chip "consensus" forecasts, published in April 1994, are as follows:

Blue Chip Consensus Projections(1)

	1994	1995	Ten-Year Average (1996–2005)
Inflation (CPI)	2.8%	3.3%	3.4%
Aaa Corporate	7.4	7.7	7.3
3-Month T-Bills	3.7	4.3	4.3

(1)April 10, 1994. Ten-year projections are as of March 1994.

These forecasts indicate that short-term interest rates are expected to increase, but long-term interest rates are expected to remain relatively low over both the near term (7.4 to 7.7 percent) and the long run (7.3 percent). Also, only modest increases in inflation are expected, with the CPI increases averaging about 3.4 percent per year long-term.

Q. HOW DO INTEREST RATES IN RECENT MONTHS COMPARE TO INTEREST RATES AT THE TIME OF THIS COMMISSION'S LAST RATE OF RETURN DETERMINATION?

A. On Table 2, I show the comparison for Moody's double A utility bond yields for the period January – July 1990 (the period used by the FCC to measure the cost of equity) versus the seven months ending March 1994. Bond yields for January – July 1990 averaged 9.63 percent compared to 7.20 percent for the most recent seven months – a dramatic reduction of nearly 250 basis points. The inclusion of data for April 1994 would only slightly affect this comparison.

While the cost of equity to telephone companies need not fall by the same 250 basis points, it is quite clear that a substantial decline has occurred and must be recognized.

IV. COST OF EQUITY UPDATE

The FCC's 1990 Estimate

Q. HOW DID THIS COMMISSION DETERMINE THE COST OF EQUITY FOR LOCAL EXCHANGE COMPANIES IN THE 1990 PROCEEDING?

A. The Commission selected the "classic" discounted cash flow (DCF) model as its analytical tool to estimate the cost of equity. This is the standard model used by most utility regulatory commissions to ascertain the cost of equity for telephone companies as well as for electric, gas and water utilities. The formula utilized is:

$Ke = Do/Po (1 + 0.5 g) + g$, where

Ke = cost of equity

Do = current annualized dividend (i.e., quarterly multiplied by 4)

Po = stock price

g = long run rate of growth of dividends

The Commission applied this model to the seven Regional Bell Operating Companies (RBOCs) as a group, recognizing that they provide the best available proxy for the local exchange companies. The Commission used published stock price and dividend data for the first seven months of 1990, the most recent data available at the time the order was being prepared.

The growth factor – probably, the most controversial component of the DCF formula – was obtained from Institutional Brokers Estimate System (IBES). IBES is an investor service which conducts a survey of institutional analysts and compiles their earnings growth rate projections, both near term and long term. The Commission used the average five-year growth rate values published by IBES for each of the seven RBOCs.

Q. WHAT RESULTS WERE OBTAINED USING THIS APPLICATION OF THE DCF?

A. The Commission's order published the following monthly estimates:

January 1990	11.71%
February	12.27
March	12.03
April	12.11
May	12.29
June	12.32
July	12.60
Average	12.19%

The Commission's analysis obtained 12.2 percent for the seven RBOCs during January – July 1990.

Q. DID THE COMMISSION EMPLOY 12.2 PERCENT TO DETERMINE OVERALL RETURN ON RATE BASE?

A. Only as a starting point. The Commission applied a series of adjustments which in combination had the effect of increasing the average DCF result from 12.2 to 13.2 percent – a full percentage point increase.

Q. PLEASE DESCRIBE THE ADJUSTMENTS.

A. The first adjustment recognized that there is variation in the DCF results among the seven RBOCs around the 12.2 percent average. Thus, to ensure that the generic cost of equity finding did not fall below any RBOC's individual cost of equity, the Commission identified a range of 12.6 to 13.0 percent. This is equivalent to an adder of 0.4 to 0.8 percent (midpoint of 0.6 percent).

The second adjustment pertains to the highly controversial "cellular effect" argument. According to this argument, RBOC stock prices (and therefore dividend yields) reflect the value of cellular telephone assets acquired by the RBOC. However, the IBES growth rates do not incorporate cellular earnings because the earnings are almost entirely beyond the five-year time horizon. In the extreme form, the "cellular effect" argues that standard application of the DCF model to the RBOCs is completely invalid. While the Commission substantially discounted the cellular argument, it included an adjustment to recognize the "possibility" of earnings growth understatement. At the same time, the FCC recognized that interstate access service is somewhat less risky than nonregulated RBOC operations. In combination, these two considerations increased the return on equity range to 12.5 to 13.5 percent, or a midpoint increase of 0.2 percent.

The final adjustment was unrelated to cost of equity itself but is merely an adder to promote "infrastructure" development. This increases the midpoint value from 13.0 to 13.2 percent.

In summary, the return on equity adders are:

(1)	Variation DCF results	+ 0.6%
(2)	Cellular effect/RBOC risk (net)	+ 0.2
(3)	Infrastructure incentive	+ 0.2
	Total Adjustment	+ 1.0%

Q. DO YOU BELIEVE THESE ADJUSTMENTS ARE NEEDED?

A. No, I do not. The three FCC adjustments are not needed and only serve to raise, improperly, the cost of interstate access service. The first adjustment recognizes that the "classic" DCF method produces differing results for the seven RBOCs. This could be due either to differing costs of equity among the companies, or more likely, simply the fact that there is some degree of randomness in stock price and IBES survey data. Using a group of seven companies is useful in that it helps to cancel out the random high/low data fluctuations. Consequently, the overall average DCF result is the appropriate measure and an adder reflecting inter-company differences is superfluous. With the adder for variation, consumers on average will pay for an excessive cost of equity embedded in rates and the LECs will be over compensated.

Q. WHY IS THE CELLULAR EFFECT ADJUSTMENT NO LONGER NEEDED?

A. The cellular argument received only limited weight in 1990 and should receive even less today. While cellular telephone was clearly an infant industry in 1990, it has progressed substantially and become much more firmly entrenched over the last four years. The argument in the 1990 case was that the IBES five-year earnings forecasts, extending at that time to 1994/1995, did not recognize cellular earnings expectations. That argument is even less credible today with cellular

profits becoming evident at this time. It is highly unpersuasive to argue that the RBOC analysts at the present time (in 1994) are overlooking the cellular profit potential given that the earnings projections extend out to 1999. In other words, it is not reasonable to argue that little in the way of cellular profits should be expected through 1999.

The passage of four years and the concomitant development of the cellular business during that time weakens the argument that analysts' earnings projections extending out five years omit future cellular profits expected by investors. For this reason, even less weight should be given to that argument today than in 1990.

Q. IS THE INFRASTRUCTURE INCENTIVE NEEDED?

A. No. It is neither necessary nor appropriate. Under this Commission's price cap plan, the LECs have already demonstrated their ability to earn in excess of the 13.2 percent midpoint return on equity, as noted in the NPRM. Within the earnings sharing threshold, the LECs may retain 100 percent of the surplus earnings, and therefore under the price cap plan, the LECs already possess substantial capital investment and modernization incentive. The Commission's 0.2 percent adder is not needed and is unrelated to the cost of equity.

DCF Update

Q. HOW HAVE YOU PERFORMED YOUR DCF UPDATE?

A. Following the FCC's basic approach, I apply the "classic" DCF formula to the seven RBOCs. I am using the latest available market data for the six months ending March 1994, and I will update to include April data at the time of MCI's Reply Comments. In my opinion, the application of the classic DCF to the seven RBOCs continues to be the most appropriate method available to estimate the cost of equity for local exchange telephone companies.

My update applies the basic formula:

$$Ke = Do/Po\ (1 + 0.5\ g) + g$$

Q. WHAT DIVIDEND YIELD RESULTS DID YOU OBTAIN?

A. The month-by-month calculation of the dividend yield for each company is shown on Table 3. For the six-month period, the RBOC dividend yield averages 4.65 percent.

The individual calculations are performed by first obtaining the annualized dividend (i.e., the indicated quarterly dividend multiplied by 4). The stock price each month is the average of the high and low for the month as reported in the Standard & Poor's Stock Guide. The yield is computed as the annualized current dividend divided by the average stock price for the month.

Q. WHAT IS THE ESTIMATED GROWTH RATE?

A. The FCC expressed a preference for the IBES growth rates, and I show that information on Table 4. The average earnings growth rate for the seven RBOCs is 6.17 percent (mean) or 6.23 percent (median), as reported for the February 1994 survey. As a check, I compared this to growth rate values as of October 1993, near the beginning of the six-month period, and obtained virtually identical results. Thus, the contemporaneous IBES survey yields a growth rate of 6.2 percent.

Q. COMBINING THIS INFORMATION, WHAT COST OF EQUITY ESTIMATE DID YOU OBTAIN?

A. Employing the classic DCF, the cost of equity for the seven RBOCs is:

$$Ke = 4.65\%\ (1 + 0.5\ (6.2)) + 6.2$$

$$= 11.0\%$$

My cost of equity finding is 11.0 percent, and I recommend that this be used in place of the current 13.2 percent. If the FCC concludes that it is proper to retain the 1.0 percentage point adjustment for variation, cellular earnings and infrastructure incentives, then the updated return on equity becomes:

$$11.0\% + 1.0\% = 12.0\%.$$

However, I do not recommend retention of these adders.

Q. YOU HAVE DEMONSTRATED THAT MARKET CAPITAL COSTS HAVE DECLINED SUBSTANTIALLY SINCE 1990. HAS THIS BEEN OFFSET BY INCREASES IN RISK FOR THE RBOCS?

A. Based upon commonly used risk indicators, there is little evidence that the investment risk profile has changed significantly since 1990. Table 5 provides various indicators from the Value Line Investment Survey for January 1990 versus January 1994. Despite the decline in the equity ratio from 60 to 57 percent,[2] there appears to be little change. All companies retain A+ for financial strength and "1" for Safety (with the exception of Bell Atlantic).[3] The RBOC dependence on non-utility (i.e., "other") revenue increased from 17.4 percent to 19.4 percent over the four years. Finally, the Value Line data show a noticeable decline in the average "beta" statistic, from 0.92 in 1990 to 0.84 in 1994. This lower beta would indicate a risk reduction, i.e., reduced volatility relative to the overall stock market.

I have also compared bond ratings in 1990 versus 1994 for the Bell operating companies since bond ratings purport to take into account a wide range of risk

[2]Value Line capital structure ratios are presented excluding short-term debt balances and therefore may differ from other sources.

[3]It should be noted that prior to the proposed merger with Telecommunications, Inc., Bell Atlantic was also rated "1" for Safety by Value Line.

factors. As shown on Table 6, there is little change in bond ratings between 1990 and 1994 for these companies.

Q. HAS THERE BEEN A TREND TOWARD INCREASED COMPETITION IN THE TELEPHONE INDUSTRY?

A. Yes, and there is obviously a connection between competition and risk. While the scope of competition for local exchange service has increased since 1990, this would imply an increase in the cost of equity (or in this case a risk increase offset to general market declines in the cost of capital) if this trend was unexpected. This is not the case. Increases in competition were predicted, widely discussed in the trade press and argued in filings before the FCC in 1990. In fact, the significance of emerging competition was noted in the FCC's 1990 order and in the 1994 NPRM. Thus, the trend toward competition, i.e., the emerging "competitive threat," was taken into account by investors in 1990 and therefore already reflected in the FCC's 1990 DCF analysis. Despite this emerging competitive threat, the LECs have operated very successfully since 1990 and do not exhibit evidence of severe financial losses from competition.

The published risk indicators for the telephone industry, shown on Tables 5 and 6, do not demonstrate that the RBOCs are riskier investments today than they were four years ago.

V. DETERMINATION OF OVERALL RETURN

Q. HOW IS THE OVERALL COST OF CAPITAL DETERMINED?

A. In addition to the cost of equity, the calculation of the overall return requires identifying the capital structure and the embedded cost of debt. In CC Docket No. 89-624, the Commission employed the recent actual consolidated capital

structures of the seven RBOCs and the debt costs of the Bell operating companies. I have followed the same approach in my statement in this case.

Q. WHY DID THE FCC UTILIZE THE CAPITAL STRUCTURES OF THE RBOCS RATHER THAN THE OPERATING COMPANY DATA?

A. The FCC was concerned about the problem of "financial manipulation," that is, a RBOC has the ability to move debt leverage from the balance sheet of an operating company to that of the holding company or to that of its nonregulated subsidiaries. Such a practice would thicken the telephone company's equity ratio, and since equity is more expensive than debt, increase the allowed overall rate of return. The use of the RBOC capital structure would prevent that unwarranted increase in rate of return and thereby protect consumers.

In the 1990 proceeding, the FCC found that the RBOC capital structures averaged 55.8 percent equity and 44.2 percent debt.

Q. WHAT IS YOUR CAPITAL STRUCTURE FINDING?

A. I have compiled the consolidated capital structures of the seven RBOCs at December 31, 1993 on Table 8, the most recent data available. These capitalization balances average to 51.3 percent equity and 48.7 percent debt. This is an average reduction in the equity ratios for these companies of about 4 percentage points as compared to capital structures in 1989.

Q. HAVE YOU COMPILED THE EMBEDDED COST OF DEBT?

A. Yes, I have. However, my estimate is based upon 1992 data because the full set of 1993 data for the Bell operating companies is not yet available. As shown on Table 7, the average embedded cost of debt in 1992 was 8.01 percent. This compares to the Commission's finding of 8.8 percent in CC Docket No. 89-624, which was based upon 1989 data.

It is my understanding that many of the Bell operating companies took advantage of the very low interest rates in 1993 to refinance outstanding high cost debt. Thus, I expect that the embedded cost of debt in 1993 may be even lower than in 1992. Hence, the 8.0 percent calculated on Table 7 is preliminary and should be updated to 1993 as soon as the data become available.

Q. WHAT IS YOUR OVERALL RATE OF RETURN?

A. I show the calculation of the overall rate of return on Table 9 using the 8.0 percent (preliminary) cost of debt, the 12/31/93 RBOC capital structure and my cost of equity estimate of 11.0 percent. These data produce a 9.54 percent overall return, which is my recommendation in this proceeding.

The bottom portion of the table shows the overall rate of return assuming a return on equity of 12.0 percent. That equity return is my DCF result including the 100 basis points for the Commission adders for cost of equity variation, cellular earnings and infrastructure incentive. This results in a 10.06 percent overall return.

VI. INTEREST RATE ADJUSTMENT MECHANISM

Q. WHAT IS THE ISSUE CONCERNING ADJUSTMENTS FOR INTEREST RATE CHANGES?

A. The Commission's NPRM notes that interest rates at this time are very low compared to previous years and could increase as the U.S. economy improves. The NPRM observes that the interest rate reduction may warrant "a one-time reduction in rates" (page 20). I am recommending such a one-time reduction in rates associated with a decline in overall rate of return from 11.25 to 9.44 percent.

The NPRM also seeks comments on "whether the Commission should adopt a mechanism which would adjust the [price cap] plan to reflect changes in interest rates." (Ibid)

Q. WHAT IS THE RATIONALE FOR SUCH A MECHANISM?

A. While the NPRM does not directly provide the rationale for such a mechanism, I interpret the discussion as suggesting that changes in interest rates are largely "exogenous," i.e., beyond the utility's control. Hence, the utility should neither enjoy the benefit nor suffer the cost associated with changing interest rates.

Q. PLEASE COMMENT ON THE NEED FOR SUCH AN ADJUSTMENT.

A. I concur with the conceptual point that changes in interest rates are essentially exogenous and thus a procedure for making the Company and consumers whole for such changes on an ongoing basis is theoretically reasonable.

As a practical matter, however, there is no compelling need for such a mechanism, and its introduction would only serve to complicate the price cap plan. My assumption is that the FCC, with or without this mechanism, would wish to reexamine the experience with price cap regulation every several (e.g., three to five) years. At each such review it could revisit the issue of appropriate rate of return and make the necessary adjustments (if any) to rates. The practical impact of an interest rate mechanism would be to effect rate adjustments between the FCC reviews.

Q. WHY DO YOU BELIEVE THAT AN INTEREST RATE ADJUSTMENT MECHANISM IS NOT NEEDED AS A FEATURE OF PRICE CAPS?

A. It is important to keep in mind the distinction between the embedded cost of debt and the market cost of debt. The utility's earnings is impacted by the former

rather than the latter. The market cost of debt becomes relevant to utility earnings only when it causes the embedded cost of debt to change.

I have noted the substantial decline in the market cost of debt since 1990, about a 2.5 percentage point reduction. In response, the utility embedded cost of debt has fallen from 8.8 to 8.0 percent (1992 data), with much of the decline probably due to refinancing activity, i.e., calling high cost debt. The most cost-effective refinancings have already been accomplished, and increases in interest rates do not trigger refinancings. In that sense, changes in the embedded cost of debt due to refinancings are asymmetric.

In the future, changes in market interest rates will change the embedded cost of debt only modestly for the following reasons:

- The vast majority of telephone company debt is very long-term at fixed rates. Short-term and variable rate debt, which do change in cost with the market, are only a small percentage (usually 10 percent or less) of total debt.
- As I mentioned, refinancing activity is likely to slow substantially unless interest rates fall dramatically. Very little cost saving refinancings will occur if interest rates rise.
- In general, the telephone companies have sufficient internal cash flow to fund all or the vast majority of their capital spending. This means that very little new debt will be needed for expansion purposes. New issuances will be needed primarily to retire the currently outstanding debt as it matures. This is a very gradual process.

For these reasons, even a significant change in market interest rates (e.g., one or two percentage points) in most cases will have only a modest impact on interest

expense and hence utility earnings in a given year. Moreover, since the modest change in interest expense could be in either direction, the absence of such an adjustment mechanism is neutral with respect to consumer versus utility interests.

Q. DOES THIS CONCLUDE YOUR STATEMENT?

A. Yes, it does.

IN THE MATTER OF	)	
	)	CC DOCKET NO. 94-1
PRICE CAP PERFORMANCE REVIEW	)	
FOR LOCAL EXCHANGE CARRIERS	)	

UNITED STATES OF AMERICA

FEDERAL COMMUNICATIONS COMMISSION

Affidavit of
Matthew I. Kahal

The foregoing statement is true to the best of my knowledge and belief.

Matthew I. Kahal

State of Maryland	)	
	)	SS
County of Montgomery	)	

Subscribed and sworn to before me, this 5th day of May 1994.

Notary Public

GINA A. JONES
NOTARY PUBLIC STATE OF MARYLAND
My Commission Expires May 1, 1997

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
	)	CC Docket No. 94-1
Price Cap Performance Review	)	
For Local Exchange Carriers	)	

TABLES ACCOMPANYING THE

STATEMENT

OF

MATTHEW I. KAHAL

Concerning: Cost of Capital

On Behalf of

MCI COMMUNICATIONS CORPORATION

EXETER
Associates, Inc.

10801 Lockwood Drive
Suite 350
Silver Spring, MD 20901

Table 1

Recent Trends in Capital Costs

1990	Annualized Inflation Rate	10-Year Treasury Yields	3-Month Treasury Bill	Double A Utility Yields
January	5.2%	8.2%	7.6%	9.4%
February	5.3	8.5	7.8	9.6
March	5.2	8.6	7.9	9.6
April	4.7	8.8	7.8	9.8
May	4.4	8.8	7.8	9.8
June	4.7	8.5	7.7	9.6
July	4.8	8.5	7.7	9.6
August	5.6	8.8	7.4	9.8
September	6.2	8.9	7.4	9.9
October	6.3	8.7	7.2	9.8
November	6.3	8.4	7.1	9.6
December	6.1	8.1	6.8	9.4
1991				
January	5.7	8.1	6.3	9.4
February	5.3	7.9	6.0	9.2
March	4.9	8.1	5.9	9.2
April	4.9	8.0	5.7	9.1
May	5.0	8.1	5.5	9.2
June	4.7	8.3	5.6	9.3
July	4.4	8.3	5.6	9.3
August	3.8	7.9	5.4	9.1
September	3.4	7.7	5.3	9.0
October	2.9	7.5	5.0	8.9
November	3.0	7.4	4.6	8.9
December	3.1	7.1	4.1	8.7

Table 1
(continued)

Recent Trends in Capital Costs

1992	Annualized Inflation Rate	10-Year Treasury Yields	3-Month Treasury Bill	Double A Utility Yields
January	2.6	7.0	3.8	8.6%
February	2.8	7.4	3.8	8.9
March	3.2	7.5	4.1	8.8
April	3.2	7.5	3.9	8.8
May	3.0	7.4	3.8	8.7
June	3.1	7.3	3.8	8.6
July	3.2	6.8	3.4	8.5
August	3.1	6.5	3.2	8.3
September	3.0	6.4	3.0	8.3
October	3.2	6.6	2.9	8.4
November	3.0	6.9	3.1	8.5
December	2.9	6.8	3.3	8.3
1993				
January	3.3	6.6	3.1	8.1
February	3.2	6.3	3.0	7.9
March	3.1	6.0	3.0	7.8
April	3.2	6.0	2.9	7.6
May	3.2	6.0	3.0	7.6
June	3.0	6.0	3.1	7.5
July	2.8	5.8	3.1	7.4
August	2.8	5.7	3.1	7.1
September	2.7	5.4	3.0	6.9
October	2.8	5.3	3.0	6.9
November	2.7	5.7	3.1	7.2
December	2.7	5.8	3.1	7.2

Table 1
(continued)

Recent Trends in Capital Costs

1994	Annualized Inflation Rate[1]	10-Year Treasury Yields	3-Month Treasury Bill	Double A Utility Yields
January	2.5%	5.8	3.0	7.2%
February	2.5	6.0	3.2	7.3
March	2.6	6.5	3.6	7.7

[1]Inflation rate is the annualized rate of increase in the CPI computed as the CPI level that month compared with 12 months prior value.

Sources: Economic Indicators, Moody's Bond Record, Federal Reserve Statistical Release, Business Week.

Table 2

Yield Comparison's on
Long-Term Debt
(Moody's Aa Utility Bonds)

January 1990	9.39%	September 1993	6.89
February	9.57	October	6.89
March	9.60	November	7.17
April	9.81	December	7.18
May	9.83	January 1994	7.18
June	9.60	February	7.34
July	9.61	March	7.74
Average[1]	9.63%	Average[2]	7.20%

Source: Moody's Bond Record, page 83, April 1994.

(1) This represents the time period employed in the FCC's last rate of return determination.
(2) This represents the most recent seven months for which a complete set of data is available.

Table 3

Monthly Dividend Yields for
Bell Regional Holding Companies
(October 1993 - February 1994)

	Oct. 1993	Nov. 1993	Dec. 1993	Jan. 1994	Feb. 1994	March 1994	Jan. - Mar. 1994 Average	Oct. 1993 - Mar. 1994 Average
Ameritech	4.29%	4.56%	4.92%	4.90%	4.69%	4.86%	4.82%	4.70%
Bell Atlantic	4.19	4.41	4.43	4.75	4.93	5.21	4.97	4.65
BellSouth	4.58	4.69	4.74	4.79	4.85	4.93	4.86	4.76
NYNEX	5.35	5.61	5.68	5.92	6.08	6.57	6.19	5.87
Pacific Telesis	4.04	3.87	3.87	3.95	3.91	5.06	4.30	4.12
Southwestern Bell	3.59	3.58	3.51	3.78	3.85	3.94	3.85	3.71
U.S. West	4.36	4.44	4.60	4.59	5.17	5.37	5.04	4.75
Average	4.34%	4.45%	4.53%	4.67%	4.78%	5.13	4.86%	4.65%

Source: Standard & Poor's Stock Guide, November 1993 - April 1994

Table 4

IBES Projections of
Long-Term Growth Rate
of Earnings per Share

	As of October 1993			As of February 1994		
	Mean	Median	No. of Estimates	Mean	Median	No. of Estimates
Ameritech	5.4%	6.0%	17	5.7%	6.0%	19
Bell Atlantic	6.5	7.0	23	7.1	7.0	21
BellSouth	6.0	6.0	20	6.1	6.0	20
NYNEX	5.8	6.0	14	5.3	5.8	14
Pacific Tel	5.8	6.0	19	5.9	5.8	16
Southwest Bell	6.9	7.0	16	7.0	7.0	15
US West	6.1	6.0	14	6.1	6.0	13
Average	6.07%	6.29%	18	6.17%	6.23%	17

Source: Institutional Brokers Estimate System, earnings estimate reports for October 1993 and February 1994.